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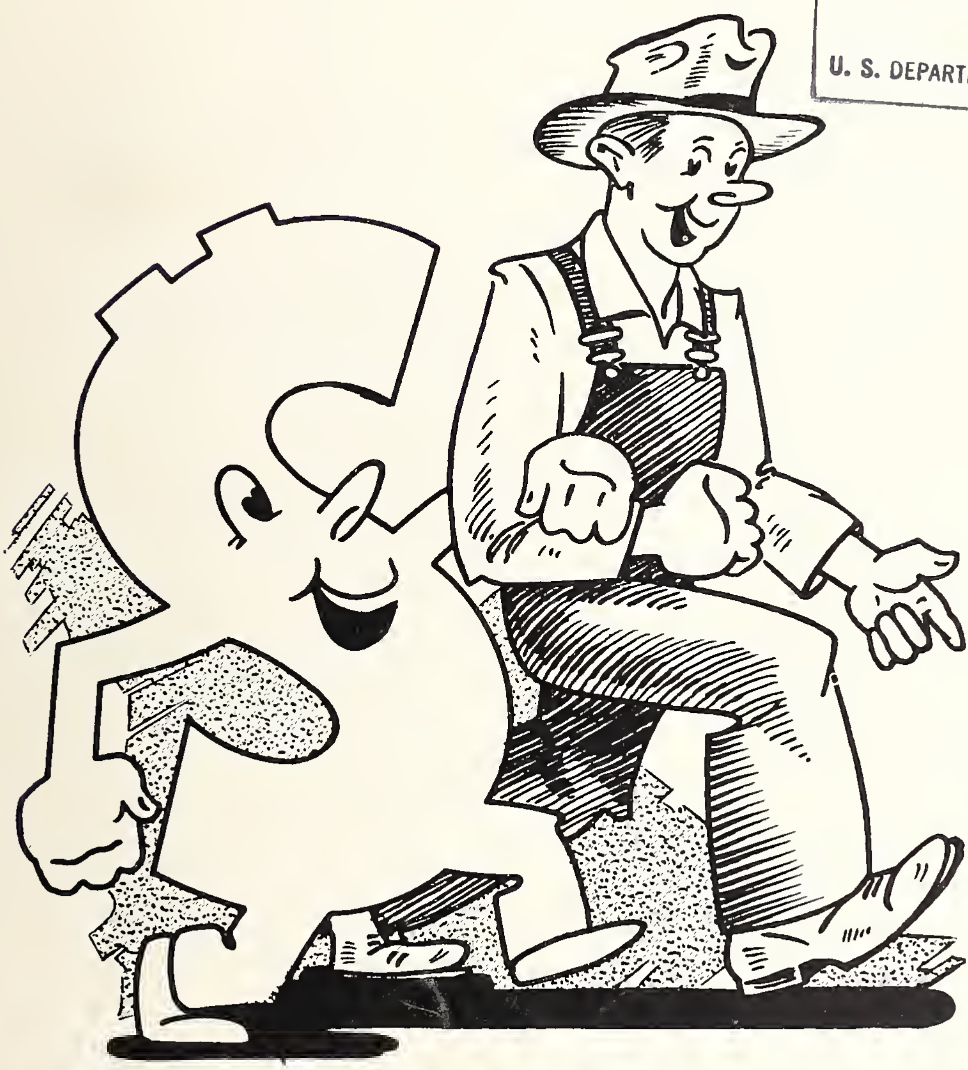
How Cooperatives Use Credit Agencies To Meet Patron's Needs



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FARMER COOPERATIVE SERVICE
U. S. DEPARTMENT OF AGRICULTURE

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U. S. DEPARTMENT OF AGRICULTURE
WASHINGTON 25, D. C.

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The Farmer Cooperative Service conducts research studies and service activities of assistance to farmers in connection with cooperatives engaged in marketing farm products, purchasing farm supplies, and supplying business services. The work of the Service relates to problems of management, organization, policies, merchandising, product quality, costs, efficiency, and membership.

The Service publishes the results of the studies; confers and advises with officials of farmer cooperatives; and works with educational agencies, cooperatives, and others in the dissemination of information relating to cooperative principles and practices.

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How Cooperatives Use Credit Agencies To Meet Patron's Needs

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Credit needs of farmers have increased greatly in the last 20 years. Technological advances in agriculture and mechanization on the farm have added to the cost of farming. These advances, while contributing to production efficiency, require the use of more and more cash or its equivalent in credit. This greater need for credit is reflected in rising amounts of accounts receivable on the books of many farm supply cooperatives as shown in recent studies.

Although credit is available to most farmers through production credit associations, the Farmers Home Administration, local banks, and other lending agencies, these institutions have not eliminated the demand for store or open-account credit. Some farmers, no doubt, prefer store credit because they look upon it as credit without an interest charge. Some farmers may also prefer it because of its convenience and its lack of "red tape" as compared with submitting financial statements and signing notes or mortgages required by the specialized credit agencies.

Whatever the reasons, cooperatives, along with other agencies selling production supplies to farmers, find themselves faced with increasing demands for credit.

Farm supply cooperatives generally have tried to limit open-account credit to an accommodation basis such as 30 days. Frequently, though, supply cooperatives have extended credit beyond even 60 days. This has sometimes tied up the co-op's operating capital which is needed for other purposes.

With the growing emphasis on vertical integration, financing of feed purchases is becoming a pressing problem in some areas. As commercial feed companies and other kinds of business firms in contract farming provide feed financing to some farmers, co-op patrons look for a similar service. Hence, in order to hold the patrons they now have and gain new ones, farmer cooperatives increasingly face the problem of supplying credit to feed purchasers for an entire feeding period. This has intensified their problem of obtaining adequate operating capital.

As contract farming is expanded by cooperatives, the need for additional capital will become still more urgent. More satisfactory sources of financing for farmer-patrons may need to be developed. In many instances, however, better adaptation and use can be made of existing credit facilities. Some cooperatives already are experimenting with ways and means of shifting open-account credit to specialized credit agencies.

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Purpose of Report

In this report the Farmer Cooperative Service and Farm Credit Administration have undertaken to: (1) describe various credit arrangements now being used by cooperatives, (2) outline the general scope of these operations, and (3) provide management of farm supply cooperatives with information helpful in making a choice of alternative methods of meeting the credit needs of their patrons.

This report deals primarily with ways some cooperatives are working with credit agencies to directly finance farmer-patrons desiring credit to purchase supplies and equipment. Also discussed are certain indirect ways local cooperatives obtain additional funds that can be used to extend credit to patrons or that release other funds for this purpose.

The report does not describe any farmer-financing operations of PCA's or commercial banks that are performed independently of arrangements with cooperatives. It does not cover the ordinary open-account credit operations of farm supply cooperatives. Neither does it consider facility and operating funds obtained from banks for cooperatives by local cooperatives handling farm supplies.

The report is descriptive in nature and is based on general information available rather than on a detailed survey of each credit agency. The appraisals in this report are not intended to be full evaluations of the credit agencies. Rather the report lists those characteristics that we believe are distinctive of each type of credit service. Since variations occur in the services of these agencies, such appraisals have only general application.

We have selected examples that best illustrate the use of existing credit services and the development of new arrangements. The names of some credit agencies or cooperatives using particular types of credit services are included in the various sections to serve as helpful references for cooperatives desiring more detailed information

Financing Patrons

Farmer cooperatives have many avenues for helping patrons meet their credit needs. For this purpose cooperatives may use some of their own working capital or obtain funds from farmers, banks for cooperatives, and commercial banks. Patrons can also be financed through the facilities of production credit associations (PCA's), credit corporations, credit unions, and commercial banks. Federal intermediate credit banks assist in such financing by discounting farmers' notes for these agencies.

These arrangements are of particular significance to local farm supply cooperatives, because they offer alternative methods of channeling much of their open-account credit through specialized credit agencies.

This section now discusses the services offered by PCA's, credit corporations, rural credit unions, and local banks in extending credit directly to cooperative patrons.

Production Credit Associations

Since production credit associations (PCA's) are themselves farmer cooperatives, they are especially interested in adapting their credit services to the

needs of patrons of other farmer cooperatives. PCA loans can be made to finance all types of farm production expenses, including capital expenditures.

Relationships with Supply Co-ops

Local farm supply cooperatives have employed a variety of methods to make PCA credit available to their patrons. We recently examined the credit control practices of local supply cooperatives in various areas of the United States. We found that these co-ops used the following methods for encouraging farmers to make greater use of their local PCA's.

1. Cooperatives acquainted patrons with PCA services.
2. Cooperatives arranged appointments for patrons and PCA representatives.
3. PCA representatives, upon request, reviewed the cooperatives' accounts receivable for potential new borrowers.
4. Cooperatives arranged to have PCA representatives take some part at annual meetings, or at least attend them and get recognition.
5. Cooperatives and PCA's jointly sponsored advertisements in local newspapers emphasizing the complementing services of each.
6. Cooperatives provided PCA's office space, on a rental basis, in or adjacent to the cooperatives' facilities.

Financing Supply Patrons

In 1957, PCA's and several supply cooperatives in the St. Paul Farm Credit district experimented with a new

procedure for handling credit. This procedure was designed to make it simpler for the patron to get needed credit and to minimize farmers' objections to the use of a separate agency to finance their purchases from the co-op.

Now over 185 cooperative organizations in the St. Paul district have completed agreements with PCA's to make loans to their patrons to finance purchases of supplies and other items. About 85 cooperatives in the St. Louis Farm Credit district have made similar arrangements. Plans and discussions are under way in varying degrees in other Farm Credit districts.

Two general types of plans are being tried under these arrangements -- the guaranty plan and the reserve plan. Under the guaranty plan, the PCA agrees to accept all loans below some agreed size and for an agreed total amount. The maximum amount varies but generally ranges between $400 and $1,000. The PCA is guaranteed against loss on such loans by the cooperative. Larger loans are handled as individual lines of credit and must be acted upon individually by the PCA loan committee. The larger loans may or may not have the cooperative's guaranty, depending upon the specific arrangements made.

The reserve plan is generally similar to the guaranty plan. However, here the cooperative does not guarantee the loan. Instead, it establishes a special reserve fund for an amount the cooperative and the PCA agree upon. The amount of reserve required is usually expressed as a percent of the amount of loans handled. This rate may vary, but it is frequently 5 percent. If there are losses in excess of this reserve, they will be borne by the PCA.

After the loan is made, the PCA services it and borrowers make principal and interest payments direct to the PCA. In many cases this initial contract between the patron and the PCA develops into a financing arrangement under which the patron obtains all of his short and intermediate credit needs from the PCA.

Since the supply cooperative undertakes some responsibility for the loans made by the PCA under both the guaranty and reserve plans, the mutual exchange of information includes data regarding the financial condition of the cooperative. In both plans the cooperative assists in the purchase of class B stock in the PCA. This stock must be owned by the borrowers in an amount not less than 5 percent of the loans made.

While there are variations in each plan, a feature common to both is that cooperative patrons who need credit can arrange for it at the time they buy their supplies. This avoids the necessity of a separate trip by the patron to a PCA or a bank. The necessary papers can be signed and other arrangements made with little or no more inconvenience than if the cooperative itself were furnishing the credit. The cooperative in turn does not have to tie up funds that can be used much more effectively in operations. Furthermore, it puts credit servicing in the hands of experienced credit people.

Cooperatives entering into production and marketing contracts with their members also may arrange for PCA's to provide credit to these members for production expenses.

Mississippi Federated Cooperatives (AAL), Jackson, Miss., has recently developed such a plan for financing commercial egg production and marketing. This plan includes a contract between the producer, the local cooperative, the regional cooperative, and the lending agency.

The contract provides that the PCA, as the local lending agency, will pay loan proceeds to the cooperative to cover the cost of baby chicks, feed, and medications furnished by the cooperative to the

producer up to an agreed maximum amount for any individual producer. The cooperative then obtains from the producer his signed note and a chattel mortgage in favor of the PCA.

Then the cooperative advances supplies to the producer as needed during the producing period. Finally, the producer repays the loan from proceeds of egg sales. The cooperative will guarantee the PCA against loss up to 10 percent of the maximum amount of individual notes for production loans.

Financing Marketing Patrons

Still another type of PCA financing of cooperative patrons is illustrated in installation of bulk milk tanks. While payment of production expenses is a major use for PCA loans, an important part of PCA's lending is for capital purposes. An increasing number of capital loans are made with maturities from 3 to 5 years in financing milk tank installations. In a number of instances financing producer-patrons of dairy cooperatives has been facilitated by a working agreement between the cooperatives and the PCA.

One such arrangement exists between the Michigan Milk Producers Association (MMPA) and PCA's in Michigan. Under this arrangement, lists of patrons are furnished by MMPA to the PCA serving the particular area. This enables the PCA to assemble in advance the credit information it needs on each patron to be financed.

The MMPA fieldman takes the orders for the bulk milk tanks from the patrons and distributes copies to all concerned, including the PCA. When the tank is installed, MMPA collects a 10 percent down payment. The producer gives a note and chattel mortgage to the PCA. When directed by the borrower, the PCA disburses to MMPA the balance of

the installation price, including the filing and abstract fee. The producer also authorizes MMPA to apply proceeds of milk sales to the repayment of the note. The note calls for monthly payments sufficient to cover interest charges and amortize the entire amount of the note in 5 years.

Appraisal

As mentioned, this report does not attempt to make a full evaluation of each financing arrangement. Only those points that seem most distinctive of each are noted. Favorable and limiting factors of PCA-cooperative financing arrangements are as follows:

Favorable factors --

1. PCA system is well established, has adequate source of funds, and operates nationwide.

2. The organization of another business entity is not required.

Limiting factors --

1. Difficulty of cooperatives and PCA's getting together on new arrangements.

2. Offices or representatives not located in every community.

Cooperative Credit Corporations

Another type of credit organization used by cooperatives is the cooperative credit corporation. Such corporations are usually organized as subsidiaries and supervised by regional marketing or farm supply cooperatives. Some of them were established by marketing associations before the formation of production credit associations. Also most of them serve farmers directly, although a few finance local cooperatives which in turn finance sales to patrons. The types financing local cooperatives are discussed in a later section.

The credit corporation usually raises original capital through its parent cooperative, but it may also raise it by selling stock to farmers or other cooperatives. Credit corporations that finance farmers directly may obtain funds by rediscounting farmers' notes with or borrowing from Federal intermediate credit banks, or from other sources. Credit corporations that finance local cooperatives may obtain funds by borrowing from banks for cooperatives.

In both types of corporations an interest rate sufficient to cover the cost of borrowed funds plus operating expenses and required reserves is charged to the borrower.

This type of financing is important in both farm supply and marketing cooperatives. Examples of corporations that have rediscounted with Federal intermediate credit banks to finance farmers include:

1. Staple Cotton Discount Corporation, Greenwood, Miss.

2. Farm Bureau Agricultural Credit Corporation, Columbus, Ohio[4]

3. Producers Livestock Loan Company, Salt Lake City, Utah

4. Midland Credit Corporation, Minneapolis, Minn.[5]

5. Maine Potato Growers Credit Corporation, Presque Isle, Maine

6. Apple Growers Agricultural Credit Corporation, Hood River, Ore.

7. Hastings Agricultural Credit Corporation, Hastings, Fla.

8. Central Jersey Farmers Cooperative Credit Assn., Hightstown, N. J.

Appraisal

Favorable and limiting factors of credit corporation-cooperative financing arrangements are as follows:

Favorable factors --

1. Adaptable to specialized needs.

2. Identified and operated as a specialized, legal credit agency meeting

[4]This credit corporation is changing from the direct financing of individuals to the financing of local farm supply associations.
[5]Now rediscounting with commercial banks.

requirements for direct borrowing from Federal intermediate credit banks or other sources.

Limiting factors --

1. In some instances, may be too restricted in original purpose and current operation to meet the needs of a changing agriculture.

2. May have insufficient capital to support volume of credit needed.

3. In some cases, close relationship with sales organization may result in relaxed credit standards in order to promote sales.

Rural Credit Unions

Some farm supply and marketing cooperatives use rural credit unions to assist their members with credit needs. As of January 1, 1957, 250 rural credit unions were sponsored by and served members of farmer cooperatives. They ranged in size from a few thousand dollars to $2.5 million of assets and varied widely in the type of service rendered.

The following will illustrate the kinds of services rural credit unions provide farmer cooperatives:

1. The Poultry Producers Federal Credit Union, San Leandro, Calif., serves farmer members and employees of Poultry Producers of Central California. This credit union makes producer loans to finance feed, supplies, and equipment purchases for members. The credit union secures its lending funds from: (1) savings of members, (2) deposits by the cooperative, (3) loans from local banks, and (4) member notes rediscounted with the Federal Intermediate Credit Bank of Berkeley, Calif.

2. The Noble County Credit Union, Albion, Ind., and Menomonie Farmers Credit Union, Menomonie, Wis., offer another service feature. They employ trained fieldmen to service loans made to farmer members.

The fieldman of the Noble County Credit Union helps farmers with their annual farm plans. The credit union uses these plans in approving loans for farmers to cover production needs for the entire season, advancing the money as needed and charging interest only on the money the farmers have used.

The fieldman of the Menomonie Farmers Credit Union assists with the credit needs of farmers seeking open-account credit at the cooperatives. He works closely with some cooperative managers in the county and serves as chairman of the credit committee.

Thus, these two credit unions are able to handle and prevent many accounts receivable problems. Their combined volume of loans outstanding as of December 31, 1957, was approximately $2.75 million.

3. In 1957 the Garden City Cooperative Equity Exchange, Garden City, Kans., was operating on a pay-as-you-go basis. Farmers had two alternatives for meeting their cash trading requirement without paying cash for each purchase. First, they could maintain an advance deposit at the cooperative equal to one month's purchases; or, second, they could maintain a line of credit at the cooperative's credit union equal to a month's purchases. Because of this credit union's various service features, many farmers used the credit union for making the prepayment and also for making other production loans.

Appraisal

The favorable and limiting factors of rural credit union-cooperative financing arrangements are as follows:

Favorable factors --

1. Rural credit unions are flexible in operation and adaptable to the varying patron credit needs of the sponsoring farmer cooperatives.

2. Close working relationships with sponsoring organizations provide opportunity for increased membership and patronage for both organizations.

3. Through the use of rural credit unions, cooperatives encourage the use of local funds and thus retain capital and benefits in the community.

Limiting factors --

1. Successful rural credit unions, like other farmer cooperatives, are dependent upon active membership relations programs.

2. Raising adequate capital within a short period of time is frequently difficult; however, in many States credit unions can borrow money from the State central credit union, local cooperatives, and other sources.

Local Banks

Many local cooperatives have developed satisfactory credit arrangements with commercial banks. While an estimate of the volume of credit handled under such arrangements is not available, a description of operational detail will show some of the potentials.

Open-Account Financing

In New Tazewell, Tenn., the county supply cooperative and a local bank have developed a program to meet more adequately the credit needs of the cooperative's patrons. Under this arrangement, a farmer estimates his seasonal credit needs. The cooperative prepares a patron note for a specific amount that is accepted by the bank for servicing and collecting.

The cooperative extends accommodation credit for 30 to 60 days, depending upon its financial strength and credit policy. At the discretion of the association, any balance on the account at the end of this period may be transferred to the bank to be charged against the patron's note. The bank charges interest only for the time the money is used by the patron.

When the cooperative forwards an account to the bank, the bank advances to the association the full amount of the patron's account up to the limit of the note. Notes carry an interest rate of 6 percent and run from 3 to 9 months.

Under this arrangement, the cooperative guarantees repayment of the note to the bank and so must be cautious in its selection of patrons eligible for notes. This practice has been working satisfactorily for 4 years and has aided the cooperative by handling up to $50,000 in patrons' credit each year.

Production Financing

At Canton, Miss., the local supply cooperative and a local bank are considering a proposal for financing egg production. Under this plan, the grower-patron signs a note at the bank for expected credit needs to cover the purchase of feed for growing chicks to laying age. A signed sales slip for each feed delivery is sent to the bank by the cooperative to be charged against the grower's note. The bank credits 90 percent of the grower's charges to the cooperative's account. Thus, the association carries only 10 percent of credit sales.

Sales proceeds from eggs sold through the cooperative's marketing facilities are applied on current feed costs, and then 85 percent of the amount remaining is applied on the grower's note at the bank.

In addition to these specific examples, many supply cooperatives discount patrons' notes at commercial banks for machinery and equipment purchases.

Appraisal

Favorable and limiting factors of local bank-cooperative financing arrangements are as follows:

Favorable factors --

1. Broad latitude for terms and services.

2. Convenience of location.

Limiting factors --

1. Services may be restricted because of established lending policy.

2. Budgeted loan services not widely promoted.

3. Banks may have to restrict credit in times of acute need.

Financing Local Cooperatives

This section of the report discusses two types of arrangements enabling local cooperatives to obtain funds that may be used to extend credit to patrons or that release other funds for this purpose.

By Regional Cooperatives

Regional wholesale supply cooperatives in several areas help finance the operations of their local retail affiliates. Such financing provides for inventories, expenses, and occasionally facilities. However, locals often use some of the funds to extend open-account credit to their farmer patrons. Locals usually obtain facility loans directly from banks for cooperatives or other sources.

Under this arrangement, the regional wholesale cooperative obtains funds on its own security from banks for cooperatives or commercial banks and uses these funds to advance operating capital to locals with interest charged on the monthly balance outstanding. Operation of this credit or financing service is usually performed by a department or division of the wholesale cooperative. The department or division must keep close check on operations of its borrowing locals, on their use of funds for inventory and open-account credit, and on the locals' potential loan security. In most cases, such locals are also under management or supervisory contracts with their regional cooperatives.

This type of arrangement is most adaptable to regionals where a uniform operating procedure is followed, where management of locals is regionally supervised, and where audits of locals are made by the regional.

Cooperatives known to be using this type of financing include:

1. Cooperative G.L.F. Exchange, Ithaca, N. Y.

2. Southern States Cooperative, Richmond, Va.

3. Farmers Cooperative Exchange, Raleigh, N. C.

4. Cotton Producers Association, Atlanta, Ga.

5. Mississippi Federated Cooperatives (A.A.L.), Jackson, Miss.

6. Iowa Farm Supply Company, Des Moines, Iowa

Appraisal

Favorable and limiting factors of regional cooperative-local cooperative financing arrangements are as follows:

Favorable factors --

1. Provide close contacts with locals, assuring continuous information on local credit needs and opportunities.

2. Provide loans and loan supervision to locals that might not be able to obtain funds on their own security.

3. Provide better control of open-account credit by the local in complying with regional lending regulations.

Limiting factors --

1. Readily accessible funds may perpetuate open-account credit at local associations.

2. Locals may object to some operating and collateral requirements of regional.

By Credit and Other Corporations

As mentioned before, credit corporations also are organized to assist in financing local cooperatives, thus enabling the locals to sell supplies to farmer members on credit. Funds supplementing capital resources of the credit corporations may be obtained through loans from banks for cooperatives, local banks, or other sources.

Such loans may be made to the credit corporation as in the case of the Cooperative Finance Association, Kansas City, Mo.; or loans may be made direct to local cooperatives with the endorsement of the credit corporation as in the case of the Wenoka Credit Corporation, Wenatchee, Wash.

Member-Association Finance Corporation

The Farmers Union Cooperative Credit Association (FUCCA), St. Paul, Minn., stresses the building up of its own capital fund from which loans are made to local member cooperatives.

Its plan for raising capital provides for a markup of 1/8 cent a gallon on gasoline and LP gas, 1/16 cent a gallon on other fuels, and 1 cent a gallon on lubricating oils purchased by member locals from Farmers Union Central Exchange, St. Paul, Minn. This amount is credited to FUCCA, and capital stock is issued for it. This arrangement is required of all borrowing cooperatives and is optional with others. Loans to local cooperatives are made from this fund. Loans are repaid by a small markup on purchases similar to that for raising capital.

This credit cooperative grew from assets of a few thousand dollars in 1938 to $1.3 million in 1957. Its common and preferred capital stock is owned primarily by local member associations.

Real Estate Holding Corporation

Midland Cooperatives, Inc., Minneapolis, Minn., and Central Cooperatives, Inc., Superior, Wis., have approached this problem of assisting local associations with their capital and facility needs in a somewhat different manner. These two regional cooperatives, together with the Mutual Service Insurance Company, St. Paul, Minn., have set up a real estate holding and developing corporation. This company, known as the "M-C-M Corporation," buys or builds facilities needed by local cooperatives. These facilities then are rented to the local associations.

Sometimes M-C-M buys facilities the local association already owns and then leases these facilities back to the cooperative on a long-term basis. Locals may be expected to provide about 25 percent of the facility capital. This arrangement provides the local cooperative with needed facilities and at the same time permits more of its own capital to be used for inventory and other operating needs -- which may include granting credit to patrons.

One key to the successful operation of this program is the funds provided by the Mutual Service Insurance Company in the form of long-term mortgage loans to the M-C-M Corporation. These mortgage loans are liquidated out of rental income.

Appraisal

Favorable and limiting factors of credit corporation-local cooperative financing arrangements are as follows:

Favorable factors --

1. Funds of regional are not tied up in financing the operations of local

associations although the regional may provide some capital for the credit corporation.

2. Relationship between the local and regional and collections from the locals may be more satisfactory when financing is handled through a separate corporation.

Limiting factors --

1. The lending ability of a credit corporation, because of limited capital, may be less than that of the regional.

2. The collateral and lending policies of the credit corporation may be more stringent than those of the regional.

General Observations

The current interest in credit problems among cooperatives emphasizes vividly the need for more comprehensive and more effective financial programs in many cooperatives. The needs to date, while increasing, have been minor compared with the developing demand for capital as integration and related coordination plans become realities. These developments will require the performance of additional services in processing and distributing farm products as well as in manufacturing and distributing farm supplies. Farmers through their cooperatives cannot accomplish these activities without significant increases in the amount of capital now provided.

Farmer cooperatives should be aware of the necessity of developing specific credit arrangements for their patrons. Experiences in the past several years indicate that an organized effort is needed to induce more farmers to use existing credit agencies. Getting local patrons to shift from open-account credit at their supply cooperative to a credit agency which makes a specific charge for credit is a selling job for management. The increasing burden of open-account credit suggests that a shift is highly desirable.

There is some reluctance among farmers to make the necessary personal arrangements for an established line of credit. However, experience in some locals has shown that a cooperative can be highly effective in introducing farmers to credit agencies and in making the services of credit agencies more convenient to farmers. In many instances, cooperatives handle the paper work, establish credit ratings and perform other activities that eliminate the need of the individual patron to even make personal contact with a lending agency.

Cooperatives extending credit without adequate financing to cover that credit may be negligent in performing services for their patrons. Failure to provide adequate credit financing may contribute to a slow-down of their operations because of excessive use of operating capital for open-account credit. Formalized plans for shifting credit to credit agencies should help supply cooperatives meet competition that extends 6 or 8 months' credit, as well as help them reduce regular accounts receivable.

Credit programs should encompass the needs of open-account, seasonal, feed, and integration credit. This can best be done by long range financial planning with each cooperative assuring itself of definite credit sources for farmers with particular needs.

For the cooperative with credit problems, it is not so much a job of pioneering new credit sources; it is really one of recognizing existing credit sources and developing an operating program on the credit framework already available.

The credit arrangements outlined in this report should offer cooperatives ideas for working out their own programs of adequate patron credit.

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